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Nos. 80-1012, 80-1030, and 80-1052

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

BAXTER RICE, DIRECTOR, DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL OF THE STATE OF CALIFORNIA, Petitioner;

BOHEMIAN DISTRIBUTING COMPANY, Petitioner;

WINE & SPIRITS WHOLESALERS OF CALIFORNIA, Petitioner,

v.

NORMAN WILLIAMS COMPANY, et al., Respondents.

ON WRIT OF CERTIORARI
TO THE COURT OF APPEAL,
THIRD APPELLATE DISTRICT,
OF THE STATE OF CALIFORNIA

BRIEF OF PETITIONER BOHEMIAN DISTRIBUTING COMPANY

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QUESTIONS PRESENTED

Assembly Bill 499, California's primary source law, provides that only licensed liquor importers designated by brand owners may purchase or accept delivery of such brands in California.

1. Does Assembly Bill 499 conflict with the Sherman Act, even though it does not require any person to engage in conduct that would violate the Sherman Act?

2. Does section 2 of the Twenty-first Amendment, which grants to the states the right to control importation and sale of liquor and to structure its distribution system, authorize California to enact and enforce a primary source law?

PARTIES

The parties to the proceeding, in addition to petitioner, a California corporation and an intervenor below, are:

1. Baxter Rice, Director, Department of Alcoholic Beverage Control.

2. Wine & Spirits Wholesalers of California, a California corporation, another intervenor below.

3. Norman Williams Company, a California corporation; Schwab Distributing Company, Inc., a California corporation doing business as Gold Coast Wines & Spirits; Lewis-Westco & Co., a California corporation; Frederica Auldridge, doing business as South Bay Liquor; Green Cat Liquors, Inc., a California corporation; Ralph E. Pierce and Sharon L. Pierce, doing business as Texas Liquor House; and William Kirby, Jr. and Shirley D. Kirby, doing business as House of Fine Spirits.

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OPINIONS BELOW

The opinion of the Court of Appeal (Pet. App. 1a-15a)[1] is reported at 108 Cal.App.3d 348, 166 Cal.Rptr. 563.

JURISDICTION

The judgment of the Court of Appeal was entered on July 17, 1980. On September 24, 1980, the Supreme Court of California denied a timely petition for hearing (Pet. App. 16a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3) (1976).

[1] "Pet. App." refers to the appendix to the petition in this case, No. 80-1030.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The Twenty-first Amendment to the Constitution, section 2, provides:

> The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

2. The Sherman Act, section 1, 15 U.S.C. § 1, provides in part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. . . .

3. The Sherman Act, section 2, 15 U.S.C. § 2, provides in part:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person to monopolize any part of the trade or commerce among the several States . . . shall be deemed guilty of a felony. . . .

4. Cal. Bus. & Prof. Code § 23672 ("A.B. 499") provides in part:

> A licensed importer shall not purchase or accept delivery of any brand of distilled spirits unless he is designated as an authorized importer of such brand by the brand owner or his authorized agent. Such distilled spirits imported into California shall come to rest at the warehouse for the account of such licensed importer . . . before sale and delivery to a retail licensee.

5. Other pertinent portions of the California Business and Professions Code are set forth at Pet. App. 19a-23a. Pertinent portions of the Oklahoma Statutes (Okla. Stat. Ann. tit. 37, § 501 *et seq.* (West Supp. 1981)) are set forth in Pet. App. 24a-25a.

STATEMENT

California has enacted a comprehensive statutory scheme which regulates the importation and distribution of liquor in California. Cal. Bus. & Prof. Code § 23000 *et seq.* (West 1964 & Supp. 1980). This scheme establishes a three-tier system of liquor distribution: retailing, wholesaling (including importing), and manufacturing (*e.g.* distilling). A license is required for each activity, and no one may hold a license to engage in activity at more than one tier. Cal. Bus. & Prof. Code § 23772 (West 1964).

One part of the California system of distribution is a "primary source" statute. Such a statute provides that a wholesaler may import liquor into the state only if it is authorized ("designated") by the distiller to do so. A primary source rule has been part of California's liquor distribution laws since 1973. *See* Cal. Bus. & Prof. Code § 23672 (West Supp. 1980) (reprinted at Pet. App. 22a). A primary source statute gives the distiller (or the owner of the brand) control of the structure of distribution: as examples, the distiller may designate one, two or many wholesalers for each brand; he may designate one wholesaler for one of his brands and a different wholesaler for others; and he may restrict the designation to sales in given metropolitan areas. Primary source laws are common to state systems of liquor regulation.[2]

The statute challenged in this litigation, A.B. 499, is a primary source law. It replaced the earlier California primary source law as a result of litigation with which the Court is familiar. *Rice v. Alcoholic Beverage Control Appeals Board*, 21 Cal.3d 431, 579 P.2d 476 (1978), invalidated Cal. Bus. & Prof. Code § 24755 (reprinted in Pet. App. 19a-22a) on the ground

[2] The primary source laws of other states are collected at Pet. App. 37a-38a. The following statutes cited at Pet. App. 37a-38a have been amended: H.B. 1271, 1981 Colo. Sess. Laws 157 (CCH) (to be codified as Colo. Rev. Stat. § 12-47-128(3)), P.A. 81-294, 1981 Conn. Pub. Acts 766 (to be codified as Conn. Gen. Stat. Ann. § 30-63); P.A. 82-480, 1981 Ill. Laws 2138; and P.A. 82-606, 1981 Ill. Laws 2796 (to be codified as Ill. Stat. ch. 43, § 126 (Smith-Hurd)).

that the system of resale price maintenance it established for the distribution of liquor conflicted with the Sherman Act. In *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980) *("Midcal")*, this Court agreed, substantially relying on *Rice*.

The primary source statute then in effect, Cal. Bus. & Prof. Code § 23672, referred to the invalid section 24755 by defining as an "authorized importer" any person designated by the "licensee who filed the *minimum retail price schedule* for such brand pursuant to Section 24755." (emphasis added). Following the decision in *Rice*, California's Department of Alcoholic Beverage Control concluded that it could no longer enforce the primary source statute in light of the nature of this reference to section 24755.

A system of vertical allocation need not be a creature of statute. Ordinarily a distiller may sell to whom it pleases, subject to the state's licensing requirements, and this ability to select customers may be all that is necessary to replicate the effects of a primary source law. This system of private choice does not always prevail in the liquor business, however, because some states have "open wholesaling" systems, under which a distiller who sells to anyone must sell to everyone. If an open wholesaling state also permits free export of liquor, the distiller's ability to select its customers in other states is undercut as well.

Oklahoma has both open wholesaling and free export statutes.[3] An Oklahoma wholesaler may sell spirits out of the state to "qualified persons." (Okla. Stat. Ann. tit. 37, § 521(e) (West. Supp. 1981) (reprinted at Pet. App. 24a). Liquor shipped into Oklahoma thus could be reshipped to California so

[3] Oklahoma's open wholesaling statute is Okla. Stat. Ann. tit. 37, § 533 (West Supp. 1981), reprinted at Pet. App. 24a-25a. The Attorney General of Oklahoma has ruled that distillers nonetheless are free to fill or not fill purchase orders for liquor to be delivered to destinations outside of Oklahoma. A state court has disagreed with this opinion and entered an order under which all attempts to control resales or to cease selling to any wholesaler are unlawful. *Central Liquor Co. v. Oklahoma Alcoholic Beverage Control Board*, No. CJ-81-1413 (D. Ct. Okla. Cty. Aug. 11, 1981), appeal pending. A copy of the opinion of the Oklahoma trial court has been lodged with the Clerk of this Court.

long as the recipient were "qualified." And the holding of *Rice,* coupled with the position of California's Alcoholic Beverage Control authorities that the existing primary source statute could not be enforced, made all California wholesalers of *any* brand "qualified" to buy *every* brand; each wholesaler had a state license to be a wholesaler. Certain wholesalers, including respondent Norman Williams Company, took advantage of this and began to purchase spirits that distillers were unwilling to sell to them directly.

To restore the system it desired, under which only certain designated importers have the right to distribute liquor into California, the California legislature in 1979 adopted A.B. 499. The statute is designed principally to nullify the extraterritorial effect of Oklahoma's law on California's liquor distribution system.

Prior to the effective date of A.B. 499, Norman Williams Company filed a petition for a writ of mandate in the Court of Appeal, Third Appellate District, seeking an order directing Rice, the Director of the Department of Alcholic Beverage Control, to refrain from enforcing A.B. 499. The petition argued, among other things, that A.B. 499 conflicts with and is preempted by the Sherman Act.

The Court of Appeal issued an alternative writ of mandate on December 31, 1979, preventing Rice from enforcing A.B. 499 pending further order of the court. As a result, A.B. 499 has never gone into effect. On July 17, 1980, the Court of Appeal held that A.B. 499 is invalid because it conflicts with and is preempted by the Sherman Act (Pet. App. 1a-15a). The court based its holding solely on the facial terms of the statute; it declined to consider evidentiary material prepared by Norman Williams Company (*id.* at 2a, n.1).

The court below based its decision on two premises: (1) the Sherman Act forecloses state laws that enable or aid any restraint on intra-brand competition; and (2) any restraint on intra-brand competition violates the Sherman Act. *See* Pet. App. 8a-10a. The court thought this conclusion was mandated

by *Midcal.* It also rejected an argument that the Twenty-first Amendment authorizes states to enact statutes that otherwise would be preempted by the Sherman Act (*id.* at 11a-15a).

SUMMARY OF ARGUMENT

1. The court below employed two false premises. The first is that the Sherman Act overrides all state laws that restrain intra-brand competition. That notion, which would preclude enforcement of state contract and tort law, as well as trade secret law, was treated as frivolous in *New Motor Vehicle Board of California v. Orrin W. Fox Co.*, 439 U.S. 96, 110-11 (1978). The second is that restraints on intra-brand competition necessarily undermine the policies embodied in the Sherman Act. That notion was put to rest in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), which held not only that the Sherman Act does not forbid all restraints on intra-brand competition but also that some restraints on intra-brand competition foster interbrand competition, "the primary concern of antitrust law," and thus are beneficial to competition.

2. In any case, A.B. 499 does not conflict with the Sherman Act because the contracts it authorizes are subject to the same Sherman Act scrutiny as any other contracts for any other products. This is so because A.B. 499 does not compel distillers and wholesalers to reach any particular territorial contracts. If such contracts are made, they will be voluntary and therefore outside the zone of implied immunity of *Parker v. Brown*, 317 U.S. 341 (1943). This case therefore differs from *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980), where resale price maintenance agreements — *per se* violations of the Sherman Act — were promoted by state law without any state scrutiny.

3. Even if it otherwise would conflict with the Sherman Act, A.B. 499 is within the scope of the power granted to the states by the Twenty-first Amendment. The statute counteracts, within California, the extraterritorial effects of Oklahoma's use of its own Twenty-first Amendment powers. The Oklahoma

open-wholesaling law otherwise has the effect of precluding a distiller from entering into a territorial allocation contract with its customers located in California. The Oklahoma customers are free to order liquor for delivery in Oklahoma and have it rerouted to California. The Oklahoma law therefore creates in California the "free rider" effect, which, as this Court observed in *Sylvania,* is a market imperfection preventing merchants from supplying promotional and repair services that would be provided if the merchants could be protected from intra-brand competition by vertical contracts. Thus, A.B. 499, by allowing California's liquor trade to benefit from vertical allocations from which any other product in California can benefit (but from which liquor trade cannot so long as open-wholesaling laws prevail), enhances interbrand competition.

ARGUMENT

I. A.B. 499 DOES NOT CONFLICT WITH THE SHERMAN ACT

There are two distinct inquiries to be made in deciding whether A.B. 499 is preempted by the Sherman Act. The first concerns the standard for measuring conflicts between state and federal law. The second concerns the content of the two laws. These inquiries are addressed in turn below.

A. In preemption cases a court should not seek out conflicts with state law

"[W]hen a State's exercise of its police power is challenged under the Supremacy Clause, 'we start with the assumption that the historic police powers of the states were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.' " *Ray v. Atlantic Richfield Co.,* 435 U.S. 151, 157 (1978), quoting *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218, 230 (1947). Unless Congress has explicitly foreclosed all state legislation in a particular area — and it plainly has not done so in the area of competitive policy—a state statute is void only to the extent it actually conflicts with a valid federal statute. *Id.* at 158. A conflict will

be found only where the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Florida Lime & Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 141 (1963) quoting *Hines v. Davidowitz,* 312 U.S. 52, 67 (1941). This Court in *Florida Lime* stated that a state law will stand where there is no "actual conflict between the two schemes of regulations [such] that both cannot stand in the same area." *Florida Lime & Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 141 (1963).

This Court's cases, of which *Parker v. Brown,* 317 U.S. 341 (1943), and its progeny are good examples, establish that states may establish their own principles of competition and regulation without offending federal antitrust principles. *Exxon Corp. v. Governor of Maryland,* 437 U.S. 117 (1978), is an especially compelling illustration. This Court upheld the validity of a Maryland statute which provided that a producer or refiner of petroleum products (1) may not operate any retail service station within the state, and (2) must extend voluntary price reduction uniformly to service stations it supplies. The parties contended that the law was preempted by the federal policy favoring competition. The Court disagreed, pointing out that "[i]n this as in other areas of coincident federal and state regulation, the 'teaching of this Court's decisions . . . enjoin[s] seeking out conflicts between state and federal regulation where none clearly exists.'" 437 U.S. at 130, quoting *Joseph E. Seagram & Sons, Inc. v. Hostetter,* 384 U.S. 35, 45 (1966). It did not matter, the Court said, that Maryland's law might retard competition: "if an adverse effect on competition were, in and of itself, enough to render a state statute invalid, the States' power to engage in economic regulation would be effectively destroyed." *Id.* at 133 (footnote omitted).

Seagram, on which the Court relied, also involved the interplay of antitrust and state regulation. It involved a challenge of the validity of New York's statutes requiring liquor brand owners to file price schedules with an affirmation that the prices were no higher than the lowest price at which sales were

made anywhere in the United States. Plaintiffs sought an injunction on the ground that the provisions conflicted with the Sherman Act. The Court disagreed, pointing out that the state's statutes did not compel anyone to disregard antitrust principles.

The Court further explained that although it was possible to envision circumstances under which a violation of antitrust law could be compelled under the New York statutes, "the existence of potential conflicts is entirely too speculative to be a basis for preemption." *Joseph E. Seagram & Sons, Inc. v. Hostetter,* 384 U.S. 35, 46 (1966).

B. The court below erred by finding a conflict where none exists

The court below failed to heed this Court's rule of caution in preemption cases. Instead, it sought out and thought it found conflict, where in fact none exists. The basis of the court's error is revealed in its rationale (Pet. App. 8a-9a):

> The designation statute gives brand owners the unfettered power to restrain competition...by merely deciding who may and who may not compete. In effect, that statute gives one private party the unlimited power to tell an independent licensed California buyer that he may not buy from an independent licensed Oklahoma seller. . . . The statute goes much further than to merely allow a manufacturer to determine to whom it will sell; it allows the manufacturer to forbid others to sell to a disfavored importer. . . . [W]e are concerned with the state-provided authority to prevent trade among others. . . . Such a grant of authority is in direct contravention of the express terms of the Commerce Clause and the Sherman Act.

This passage contains the premises that explain why the court found a conflict between the Sherman Act and A.B. 499: (1) the Sherman Act forecloses state law solely because the state law aids in restraining intra-brand competition; (2) restraints on intra-brand competition necessarily undermine the policies of the Sherman Act. Both premises, as the

following discussion shows, are false and these false premises led the court to a result that, as the Solicitor General aptly observed, "is plainly incorrect" (U.S. Br. 8).

1. The Sherman Act does not preempt state laws just because those laws facilitate restraints on intra-brand competition

It is too plain for argument, in light of the Court's precedents on preemption, that states may enact statutes affecting the process of intra-brand competition. In *New Motor Vehicle Board of California v. Orrin W. Fox Co.*, 439 U.S. 96, 110-11 (1978), the Court treated as frivolous an argument that a California statute was preempted by the Sherman Act because it "permits auto dealers to invoke state power for the purpose of restraining intra-brand competition." In this case the arguments supporting the state's statute are even more powerful than they were in *Fox*.

a. Federal law protects competition, not competitors

We start from the premise that there is no conflict between state and federal law just because state law may put some wholesalers at a disadvantage. Federal antitrust law protects the process of competition, not the welfare of particular competitors. See, *e.g.*, *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977); *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). The desire of respondent Norman Williams Company and similarly situated firms to profit from selling liquor plays no role in antitrust analysis. *Sylvania, supra*, 433 U.S. at 52 & n.21.

Many state laws harm particular firms but promote the process of competition. For example, state laws concerning trade secrets and business torts may place some firms in positions of advantage relative to others, but these state laws are desirable complements to federal policy. They enable inventors and other entrepreneurs to reap the rewards of their

efforts and so increase the welfare of consumers over the long run. See *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979); *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974). Similarly, state statutes may assist the competitive process by enabling firms to control the process by which their products are distributed.

b. Restrictions on distribution promote competition in "soft" product attributes and thus further federal policy

The Court held in *Sylvania* that territorial restrictions on distribution of a product may promote competition. As the Solicitor General observed (U.S. Br. 8, 15-18), this fact should be the end of this case. The state's statute—which facilitates territorial restrictions and other vertical arrangements concerning distribution — cannot be preempted unless all forms of restricted distribution are anticompetitive. Yet *Sylvania* establishes that many forms of restricted distribution are procompetitive. If exclusivity is beneficial or even competitively neutral, then the state court's point — that California provides distillers with a way to *enforce* their decisions concerning distribution, despite the open wholesaling laws of Oklahoma — offers praise of the statute, not condemnation.

As the Court stressed in *Sylvania*, territorial and related restrictions facilitate competition in product attributes that manufacturers cannot control at the factory.[4] Distillers can control directly the flavor, alcohol content, and packaging of their products, but they must induce others (wholesalers and retailers) to provide that collection of additional attributes, such as courteous service, knowledgeable personnel, prompt availability of brands, and so on, that consumers value.

[4] *Sylvania* involved location clauses rather than exclusive territories or other restraints, but the Court treated them as equivalent. 433 U.S. at 45-47.

The Court recognized, as scholars have discussed,[5] that any attempt to induce dealers to provide the services directly produces intractable problems of monitoring, while indirect methods, such as pointing out what consumers want, fall prey to "free riding." If one wholesaler provides the necessary services, retailers or customers can take advantage of the advice and full stocks on some occasions but divert ordinary purchases to other wholesalers; these others will attract business by offering lower prices, which they can do because they do not bear the costs of providing the services in question. Free riding by dealers is, in effect, a selective tax on what we here for convenience call the "soft" product (dealer-provided) attributes; it leads to too little service, as customers see things. They would like to obtain the services, even at a cost, but they cannot because dealers, afflicted by the "tax," produce less.

Territorial, customer, and other restrictions attack free riding by reducing the ability of customers to go to one dealer for costly services while directing the bulk of their purchases elsewhere. The restrictions reduce the size of the free riding tax. As a result, dealers will provide that mix of "hard" (manufacturer-provided) and "soft" attributes that customers value most. This is beneficial to everyone.

There is simply no reason to think that manufacturer-controlled territorial or other like vertical restrictions can harm competition. As distillers see things, the difference between the price they get from wholesalers, and the price wholesalers get from retailers, is the "cost of wholesaling." Distillers want this cost of wholesaling to be as small as possible, consistent with the provision of the "soft" services consumers value. The costs distillers incur in furnishing these services are no different in

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[5] *See, e.g.*, the work of Judges Bork and Posner. R. Bork, *The Antitrust Paradox* 288-98, 430-34 (1978); Bork, *Vertical Restraints: Schwinn Overruled*, 1977 Sup. Ct. Rev. 171; Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 18-22 (1981); Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. Chi. L. Rev. 1 (1977). *See also, e.g.*, Baker, *Interconnected Problems of Doctrine and Economics in the Section One Labyrinth: Is Sylvania a Way Out?*, 67 Va. L. Rev. 1457 (1981).

principle from the costs distillers incur in improving the flavor or packaging of a brand. Distillers are not interested in wasting their money, and they would no more establish a system of distribution that furnished excessively-costly services than they would design excessively-costly bottles; the excess cost picks the distillers' pockets. In every case, the distiller's interests are congruent with those of the consumer. Courts do not attempt to determine whether liquor bottles are too ornate; similarly, there is no need for them to determine whether manufacturers have designated too few wholesalers in a given location.[6]

The value of "soft" product attributes is apparent in the spirits business. Customers value knowledgeable salesmen, convenient and comprehensive stocks, and so on. Limits on the number of distributors in a given territory enable wholesalers to provide these services without fear that customers, having obtained the services from one vendor, will place the bulk of their orders elsewhere.

Restrictions on distribution also contribute to the introduction and promotion of new brands. If many wholesalers handle a given brand in the same territory, no one wholesaler has adequate incentives to promote that brand. If he promotes the brand — perhaps by advertising, or perhaps by placing it at a discount in bars — he has no assurance that he will make the sales that the promotion generates. Other wholesalers who did no promotion are likely to obtain some share of the new sales. Thus multiple distributors have an incentive to be passive, each hoping to obtain a free ride on the efforts of the others. As a result, there will be less new brand introduction and promotion than consumers would prefer.

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[6] This would hold true even if there were no competition among distillers. A monopolist, no less than a competitive firm, strives to design products consumers prefer. The monopolist gains by being able to set a monopoly price for the most-desired bundle of attributes. But the Court need not adopt this position in order to sustain California's statute. Here, it is undisputed that there are many distillers in the market.

The benefits available to consumers from enhanced competition in the provision of "soft" product attributes *are caused by* the restrictions manufacturers place on their dealers. Nothing in *Sylvania* hints that the ability of distributors to procure products against the manufacturers' wishes in order to evade territorial exclusivity is some sort of "safety valve" necessary to make exclusive territories lawful. Far from it. To the extent the manufacturer is unable to enforce exclusivity the benefits of the practice disappear. Thus the critical step in the Court of Appeal's reasoning — that *enforced* exclusivity must be unlawful *per se* to the extent enforcement is effective — contradicts the rationale of *Sylvania.* The Solicitor General has made the critical point in observing that the state's "enforcement of such restraints through a designation statute would in those circumstances further rather than conflict with federal antitrust policy" (U.S. Br. 17 n.14).[7]

In most businesses, a legal rule banning restricted distribution practices would simply increase the incentives of the manufacturer to enter the distribution business itself. What it did with its wholly-owned outlets would be of no antitrust concern. This has led several courts to adopt a legal rule that restricted distribution practices are lawful at least whenever the manufacturer could have entered the distribution business internally or by merger-that is, almost always. See, *e.g., Red Diamond Supply, Inc. v. Liquid Carbonic Corp.*, 637 F.2d 1001 (5th Cir. 1981), *cert. denied sub nom, Red Diamond Supply, Inc. v. Acme Welding,* 50 U.S.L.W. 3246 (U.S. October 6, 1981) (No. 80-1987)[8]. Under such an approach restricted distribution is lawful *per se* in all but name, and A.B. 499 is

[7] By "in those circumstances" the Solicitor General evidently meant all circumstances in which vertical restrictions on distribution would be beneficial if procured by the manufacturer regardless of the state's actions. The brief thus makes the point that if the underlying vertical restraint is desirable, the state's willingness to enforce the private decision cannot be undesirable.

[8] See also *Muenster Butane, Inc. v. Stewart Co.*, 651 F.2d 292 (5th Cir. 1981) (unless the manufacturer has substantial market power, any restricted distribution arrangement is lawful); *Ron Tonkin Gran Turismo, Inc. v. Fiat Distributors, Inc.*, 637 F.2d 1376 (9th Cir. 1981), *cert. denied* 50 U.S.L.W. 3246 (U.S. October 6, 1981) (No. 80-2080) (exclusive territories are not unlawful when employed by manufacturers with small market shares).

lawful as applied to all brands and all distributors. This is the appropriate treatment of the subject, we submit, a treatment covered in exhaustive detail in the writings of Judges Bork and Posner. *See* note 5, *supra.*

2. At all events, A.B. 499 does not purport to immunize any unlawful restricted distribution practices and thus cannot offend federal statutes

If the Court agrees with petitioner's argument so far, it can remand with instructions that the Court of Appeal enter a judgment declaring A.B. 499 to be consistent with the Sherman Act. And even if the Court does not agree with the position that restricted distribution agreements are uniformly consistent with the Sherman Act (at least when initiated by manufacturers), it would not follow that A.B. 499 is open to challenge. To the contrary, because A.B. 499 does not *authorize* any particular restrictions, but only provides that restrictions desired by brand owners will be enforced, it does not conflict with the Sherman Act in any manner.

The manufacturer or brand owner has complete discretion under A.B. 499 to designate as many or as few wholesalers, per brand or by territory, as it pleases. The statute does not endorse or promote any particular pattern of designation; it simply enforces the manufacturer's choice. The manufacturer thus remains fully liable for its own choice, as the Solicitor General emphasized (U.S. Br. 12-14), and as *Cantor v. Detroit Edison Co.*, 428 U.S. 579, 592 (1976), holds.

Because the statute does not purport to compel any conduct or confer any immunity, it cannot be inconsistent with the Sherman Act. If a given restricted distribution arrangement would be lawful, and the statute enforces that arrangement, there is no problem because there is no substantive violation. And if a given distribution arrangement would be unlawful, there is still no need to consider preemption of the statute, because the manufacturer's designation may be attacked directly under federal law.

3. The Court's decision in *Midcal* does not justify the order invalidating A.B. 499

The Court of Appeal thought this Court's decision in *Midcal* compels a judgment that A.B. 499 is preempted. It does not. *Midcal* involved a system of resale price maintenance, which the Court held to be unlawful *per se* as a matter of antitrust policy and to be outside the ambit of *Parker v. Brown.* The statute at issue in *Midcal* compelled firms to employ resale price maintenance but did not govern the prices to be charged. The Court saw the statute as a bare attempt by California to authorize private parties to violate the Sherman Act.[9]

A.B. 499 is altogether different. It does not authorize any violation. It simply enforces a system of distribution to be designed by the brand owners. If the brand owners' designations are lawful under *Sylvania,* then the state's enforcement is lawful too. See *Grant-Billingsley Liquor Co.* v. *Lennen,* 449 U.S. 943 (1980), dismissing for want of a substantial federal question an appeal from *Colby Distributing Co. v. Lennen,* 227 Kan. 179, 606 P.2d 102 (1980), a case that upheld the Kansas system of territorial allocation.

II. THE DECISION OF THE COURT BELOW DENIES CITIZENS OF CALIFORNIA THEIR TWENTY-FIRST AMENDMENT RIGHT TO ADOPT LEGISLATION TO PROMOTE COMPETITION AMONG DIFFERENT BRANDS OF LIQUOR IN CALIFORNIA

The decision of the court below is wrong for another reason. It deprives California of its Twenty-first Amendment right to enact legislation controlling the importation and dis-

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[9] Primary source laws are not related to resale price maintenance laws. Some jurisdictions, such as the District of Columbia (D.C. Alco. Bev. Control Bd. Regulations, tit. 3, ch. 1 § 4.11 (1980)) and Texas (Tex. Alco. Bev. Code Ann. § 37.10 (Vernon 1978)), have long had primary source laws and no resale price maintenance laws. Other jurisdictions, such as Massachusetts (Mass. Gen. Laws Ann. ch. 138, § 25B, 25C (West 1974 & Supp. 1979)), had resale price maintenance laws but no primary source laws. A comparison of primary source laws and resale price maintenance laws is set forth in tabular form in Wine and Spirit Wholesalers of America, Inc. 1976-1979 Cumulative Supplement to the Three-Tier System of Distribution in the Wine and Spirit Industry (November 1979).

tribution of liquor. Indeed, it deprives California of the right to enact a law that promotes competition between different brands of liquor in California.

This Court has said that "[c]onsideration of any state law regulating intoxicating beverages must begin with the Twenty-first Amendment . . . ." *Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35, 41-42 (1966), and that the Twenty-first Amendment confers on each state the power to prohibit entirely or to limit and regulate the traffic in intoxicating liquors within the state. *State Board of Equalization v. Young's Market Co.*, 299 U.S. 59 (1936); *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980). In *Midcal* the Court explained (*id.* at 110):

> There is no bright line between federal and state powers over liquor. The Twenty-first Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system.

Pursuant to the power granted by the Twenty-first Amendment, California has enacted a comprehensive statutory scheme. Every aspect of the business is regulated (and taxed). The statutory scheme establishes a three-tier system of liquor distribution in California, similar to that of other states. A specific license is required for each activity; no one may hold a license to engage in activity at more than one tier. Cal. Bus. & Prof. Code § 23772 (West Supp. 1980). A.B. 499, the statute whose validity was placed in question by the lower court, is an important part of this scheme.

A designation or primary source law such as A.B. 499 permits the distiller and its customers to allocate sales territories. Whether the particular statute provides that the brand owner designate its wholesaler, and only that wholesaler can receive or purchase brand liquor (as in California) or that a supplier may not sell to a wholesaler unless it is the primary source of supply of the brand (as in Arizona), the effect is to

give the brand owner the ability to enforce contracts calling for vertical nonprice restrictions on dealers. *See* Ariz. Rev. Stat. Ann. § 4-243.01A (West 1981). Without such a statute, a purchaser in an open wholesaling state may route its purchases to California and nullify the contracts between the brand owner and its California wholesalers. The ordinary self-help remedy — terminating sales of offending dealers — is wiped out by the acts of the open wholesaling state. As the Solicitor General remarked (U.S. Br. 16-17), the California statute "cancels out the effect of Oklahoma law by restoring to a distiller or brand owner the power that Oklahoma law had taken away: the power to impose territorial restraints in California. . . ."

Without the shield of a primary source law, liquor would become the only article of commerce that may not be the subject of effective vertical territorial contracts. It was therefore reasonable for California to adopt a measure to secure, for its liquor consumers, the same benefits of competition from vertical territorial contracts that California consumers can receive for all other articles of commerce.

Any other conclusion would yield the anomalous result that the Twenty-first Amendment, by giving Oklahoma power to have an open wholesaling law, interfered with the right of California to enforce for liquor contracts what it could enforce for any other products. Whatever the outer reach of state power under the Twenty-first Amendment, it is surely broad enough to countervail the extraterritorial effects of another state's exercise of power under the same amendment.

CONCLUSION

The judgment of the Court of Appeal should be reversed.

Respectfully submitted.

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